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Supreme Court of the United States

OCTOBER TERM, 1936.

No. 563

PARK L. HOFFMAN, substituted for R. G. HOLSING, Receiver of First National Bank of Boswell, Pennsylvania, *Petitioner*,

v.

HENRY I. RAUCH, Administrator, EMILINE B. RAUCH, late of Jenner Township, Somerset County, Pennsylvania, *Respondent*.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF.

JOHN F. ANDERSON,
JOSEPH LEVY,
Attorneys for Petitioner.

GEORGE P. BARSE,
Attorney for the Comptroller of the Currency, of Counsel.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS OF THE THIRD CIRCUIT.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Park L. Hoffman, as Receiver of the First National Bank of Boswell, Pennsylvania, by direction of the Comptroller of the Currency, respectfully prays that a writ of certiorari issue to review the decree of the United States Circuit Court of Appeals for the Third Circuit in the above captioned cause entered October 9, 1936, unreported but printed in the record, page 52.

I.

Summary of Matters Involved.

A trust has been impressed on the assets of a National bank in the hands of a Receiver for the proceeds of bonds held in safekeeping for one customer and sold by the bank five days prior to suspension to another customer, apparently without intent to defraud, in that substitute bonds were immediately ordered by the bank (R. 29-30). The record establishes that the sale proceeds consisted only of bookkeeping entries in the form of a charge against a general deposit account in the same bank. The question is whether the trust may be upheld.

The facts are not in controversy. The First National Bank of Boswell, Pennsylvania, was declared insolvent on January 26, 1932, and a Receiver was appointed by the Comptroller of the Currency (R. 13). On January 21, 1932 the bank's cashier sold four Liberty bonds of the par value of $400, held by it in safekeeping for Emiline B. Rauch, to Josiah or Rose Lohr, depositors of said bank and charged their account with the sum of $400.24 as the purchase price of said bonds (R. 29). On the next day the bank's cashier mailed its check in the amount of $402.08 to a broker for the purchase of four similar bonds but the purchase was not completed prior to the bank's suspension (R. 29, 30). The Receiver offered the respondent a general claim in the amount of $402.08 which was rejected (R. 30). The respondent-plaintiff sued at law (R. 4) and the District Court directed the jury to find for the plaintiff in the amount of $402.08 (R. 31). Thereafter, in the same proceeding, on motion for rule (R. 33), and answer (R. 35) wherein the Receiver denied that the assets that passed to him had been augmented by the transaction or that the proceeds were traceable into such assets, the District Court allowed the plaintiff a preferred claim in the amount of $402.08 against all of the assets that passed to the Receiver (R. 39-41). The District Court's decree was affirmed by the Circuit Court of Appeals (R. 52).

The petitioner contends that under the record facts and the decisions of this Honorable Court no trust can be impressed on the assets that passed into his hands because those assets were not augmented when the bank surrendered possession of the respondent's bonds prior to suspension and that consequently no proceeds of the sale can be traced to the Receiver.

II.

Reasons Relied on for Allowance of Writ.

Petitioner believes that the writ of certiorari should be granted because:

(a) The decision of the Circuit Court of Appeals, impressing a trust on the assets that passed to the bank Receiver despite record proof that those assets were not augmented by the bank's sale of the respondent's bonds, is in conflict with the principles applied by this Honorable Court in *Adams* v. *Champion*, 294 U. S. 232, 239; *Jennings* v. *U. S. F. & G. Co.*, 294 U. S. 216, 222; *Old Company's Lehigh* v. *Meeker*, 294 U. S. 227, 229; *Texas & Pacific Railway Co.* v. *Pottorff*, 291 U. S. 245, 261 note 19 and *Blakey* v. *Brinson*, 286 U. S. 254, 263.

(b) The Circuit Court of Appeals has rendered a decision in conflict with the decisions of other Circuit Courts of Appeal on the same matter. The large number of bank failures in recent years has greatly increased the number of trust claims asserted by persons seeking to avoid the pro rata distribution. As a result, scores of actions involving such claims have been decided by District Courts and Circuit Courts of Appeal which now hold uniformly that to prevail the claimant must establish a trust relationship, augmentation of the bank's assets, and tracing of the proceeds to the Receiver. The National Bank Act contemplates a uniform system for winding up the affairs of insolvent National banks (*Cook County National Bank* v. *United States*, 107 U. S. 445) and this court has recognized

the importance of uniformity in this class of cases by granting reviews and reversing the Appellate Courts in *Jennings* v. *U. S. F. & G. Co.*, *Adams* v. *Champion and Blakey* v. *Brinson, supra.* The decision of the Circuit Court of Appeals in the instant case is now the only Appellate Court decision in conflict with the settled Federal rule. The class importance of the decision of the court below is already evidenced by the fact that it is the principal authority relied on in a brief recently filed with Judge Avis, United States District Court, District of New Jersey, by the plaintiff in *Atlantic City Theatre Co.* v. *Faircloth, Receiver of the Chelsea-Second National Bank,* where, as in the instant case, neither augmentation nor tracing appear. Shall Judge Avis apply the rule of the instant case, or shall he apply the settled Federal rule he has consistently followed in these cases, his last decision being in *Steuber* v. *O'Keefe,* 16 Fed. Supp. 97 (Adv. Sh.).

(c) The Circuit Court of Appeals has decided an important question of general law in a way probably untenable and in conflict with the weight of authority.

WHEREFORE, it is respectfully prayed that this petition for writ of certiorari be granted.

JOHN F. ANDERSON,
JOSEPH LEVY,
Attorneys for Petitioner.

GEORGE P. BARSE,
Attorney for the Comptroller of the Currency, of Counsel.

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BRIEF IN SUPPORT OF PETITION.

I.

Opinions of Courts Below.

The opinion and decree of the District Court are set out in the Record at pages 39 and 41 and are not reported. The opinion of the Circuit Court of Appeals for the Third Circuit is found in the Record at page 47 and is not yet reported.

II.

JURISDICTION.

The decree of the Circuit Court of Appeals to be reviewed was entered October 9, 1936 (R. 52). Jurisdiction

is conferred upon this Court to review this cause by writ of certiorari under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (U. S. C. Title 28, Section 347).

III.

Statement of the Case.

A statement of the case is set forth in the foregoing petition under the caption "Summary of Matters Involved", to which reference is here made.

IV.

Specification of Errors.

The Appellate Court erred in holding that the proceeds received for the bonds when sold augmented the assets of the bank.

The Appellate Court erred in impressing a trust in any amount on the assets that passed to the Receiver.

The Appellate Court erred in not requiring the respondent to participate in the pro rata distribution provided by the National Bank Act.

V.

Argument.

Section 5236 U. S. R. S. (12 U. S. C. Ch. 2, Sec. 194) (App. p. 11) "provides for a distribution of the entire assets of the bank, giving no preference to any claim except for moneys to reimburse the United States for advances in redeeming the notes." *Cook County National Bank* v. *United States*, 107 U. S. 445, 450. With this exception even the United States must participate in the pro rata distribution unless it has taken the security provided by law.

The respondent can avoid participation in the pro rata distribution only upon affirmative proof that the bank held the decedent's property in trust and that this property in

its original or changed form passed into the hands of the Receiver. As stated by this court in *Texas & Pacific Railway Co.* v. *Pottorff*, 291 U. S. 245, 261, Note 19:

> "The claimant has the burden of identifying the property in its original or altered form. Schuyler v. Littlefield, 232 U. S. 707. It is not enough to show that at the time of receipt the general assets of the insolvent were increased or that debts were discharged. Wuerpel v. Trust Co., 238 Fed. 269, 272, 3; Knauth v. Knight, 255 Fed. 677; State Bank of Winfield v. Alva Security Bank, 232 Fed. 847; In re See, 209 Fed. 172; In re Dorr, 196 Fed. 292; City Bank v. Blackmore, 75 Fed. 771; compare Railway v. Spiller, 274 U. S. 304, 311; Cunningham v. Brown, 265 U. S. 1."

The record establishes that the bank held the decedent's bonds as bailee but sold and surrendered them five days prior to its suspension in exchange for a general credit balance already on its books, accomplished by bookkeeping entries only. When the bank surrendered the bonds it no longer held anything in trust but had a mere personal liability to the beneficiary for a breach of trust. "An obligor cannot be trustee either of his duties or of the obligee's rights under the obligation." American Law Institute, Restatement of the Law of Trusts, Sections 74-c and 87. "The cancellation of the credit balance by the debit neither suggests any intention to establish a trust nor points to any identifiable thing which could be the subject of it." *Blakey* v. *Brinson*, 286 U. S. 254, 263. "The very essence of the right of priority over other creditors depends upon the setting apart of a particular fund for the benefit of the depositor. There is no basis for giving one depositor a priority over another unless this is an essential part of the transaction." Mr. Justice Stone, "Legal Problems in the Transmission of funds." Columbia Law Review June 1921. Page 525.

In its opinion (R. 50) the court below refers to this court's recent decisions in *Jennings* v. *U. S. F. & G. Co.*,

supra, Old Company's Lehigh v. *Meeker, supra,* and *Adams* v. *Champion, supra,* and states "but in all of them there existed the relation of debtor and creditor between the bank and the depositor which distinguishes them from the case at bar." We submit that this statement is incorrect when applied to the claim based on the Veesaert bonds in *Adams* v. *Champion* and that this court's disposition of that claim conclusively classifies the claim in the instant case as general only.

This court held that the Veesaert bonds were held by the bank in trust, which is also true of the instant case and in both cases the bonds were disposed of prior to the bank's suspension. In *Adams* v. *Champion* the bank received for the bonds a solvent credit in the amount of $1597.31 with a Chicago bank, but as only $776.57 was admittedly traced to the Receiver this court denied the trust sought to be impressed for the remainder of $820.74 (p. 239). In the instant case the bank received nothing but a transfer of bookkeeping credits in exchange for the bonds, consequently the entire trust claim should have been denied for failure to prove either augmentation or tracing of funds.

The basis for the error of the courts below is indicated by the language of the Appellate Court's opinion (R. 51) "With the District Judge we think that the proceeds of these bonds augmented the assets of the bank. They certainly reduced its liabilities to others." But it is settled, in the Federal courts, that a reduction of the bank's liabilities to others is not sufficient to create a trust against the assets that passed to the Receiver and this court said in this connection in *Jennings* v. *U. S. F. & G. Co., supra* at pages 224, 225:

> "But the situation is very different when what has been received by the collecting agent is not a thing at all, but a reduction of liabilities by set-off or release. Blakey v. Brinson, supra; People v. Merchants & Mechanics Bank, 78 N. Y. 269, 272, 273; Hecker-Jones-Jewell Milling Co. v. Cosmopolitan Trust Company,

supra, p. 187; City Bank v. Blackmore, 75 Fed. 771; Anheuser-Busch Brewing Association v. Clayton, 56 Fed. 759; Farmers National Bank v. Pribble, 15 Fed. (2nd) 175, 176; Dickson v. First National Bank, 26 Fed. (2nd) 411; Schilling v. Rowe, 64 F. (2nd) 188, 190; Allied Mills v. Horton, 65 Fed. (2nd) 708, 710; Smith v. Zemurray, 69 F. (2nd) 5, 6, 7; First National Bank of St. Petersburg v. Miami, 69 Fed. (2nd) 346; Wisdom v. Keen, 69 Fed. (2nd) 349. A debt does not furnish a continuum upon which a trust can be imposed after cancellation or extinguishment has put the debt out of existence.

The truth of this statement, though obvious enough upon its face, finds point and confirmation when the benefit, if any, accruing to the debtor is viewed as of the time of insolvency or later. What was done by the collecting bank through a settlement in the clearing house has not increased the assets available for distribution in the hands of the receiver. What was done through that settlement has had no effect after insolvency except to diminish liabilities. *The dividend that would be due upon the debts canceled through the set-off if they were now to be revived is the measure of any benefit accruing to the creditors. Decisions of other courts, to the extent that they give support for a different conclusion are built, as we think, upon an inadequate analysis, and do not win our approval.* It is the benefit to the creditors, not the loss to the respondent, that marks the gain to the fund now held by the receiver. If the respondent is permitted to prove against the assets on a parity with other creditors, the share thus allotted will correspond accurately to whatever accretion has resulted from the act of set-off and cancellation in the operations of the clearing house." (Italics ours.)

We can cite many decisions of the Circuit Courts of Appeal in conflict with the decision of the court below but believe it sufficient to refer to those listed at page 224 of this court's opinion in *Jennings* v. *U. S. F. & G. Co., supra,* which include *City Bank* v. *Blackmore* (C. C. A. 6), 75 Fed. 771, opinion by the then Circuit Judge Taft, and *First Na-*

tional Bank of St. Petersburg v. *Miami* (C. C. A. 5) 69 Fed. (2nd) 346, wherein the Circuit Court of Appeals reversed its prior decision reported in 58 Fed. (2nd) 561, after twice certifying the question to this court. The most recent of these Liberty bond cases is *Marchant* v. *Summers* (C. C. A. 4) 79 Fed. (2nd) 877, which cites *Gwynn* v. *Spurway*, 28 Fed. (2nd) 37, in both of which a trust is impressed because, *unlike the instant case*, the proceeds were traceable to the Receiver.

VI.

Conclusion.

It is believed that the foregoing discussion and citation of authorities demonstrates that the decision of the court below is erroneous and it is earnestly urged in the interest of uniformity of decisions applicable to the administration of insolvent National banks throughout all the States that this Honorable Court entertain a review of this case on writ of certiorari.

Respectfully submitted,

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APPENDIX.

Title 12 U. S. C. A., Sec. 194.

DIVIDENDS ON ADJUSTED CLAIMS; DISTRIBUTION OF ASSETS. From time to time, after full provision has been first made for refunding to the United States any deficiency in redeeming the notes of such association, the Comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, shall be paid over to the shareholders of such association, or their legal representatives, in proportion to the stock by them respectively held. (R. S. 5236.)